NEWSLETTER

Miles Capital Education

APRIL 2019

Fixed Income Markets Spring Ahead in the First Quarter

The economy showed continued strength through the first quarter of 2019. Corporate earnings and sales remained strong, labor markets remained tight, home sales still increased (albeit at a slower rate), and consumer spending remained strong. The Institute of Supply Management, a leading economic indicator, remains positive. After raising rates nine times since December 2015, the Federal Reserve (Fed) is now adopting a more a patient stance towards rates and the balance sheet reduction, indicating that they will pause in 2019 as they assess ongoing economic conditions.

While 2018 ended with dark clouds over the U.S. markets and a deep freeze over the country, spring time has arrived with the markets rebounding in the first quarter by delivering one of the best quarterly performances in nearly six years. A number of factors contributed to the strong performance but perhaps the biggest factor was the changing tone of the Fed. Weaker economic indicators, especially overseas, drove more investors into the U.S. fixed income markets and into the safety of U.S. Treasury securities which pushed longer term interest rates to levels not seen since early 2018.

The Bloomberg Barclay's Aggregate index, a broad measure of the investment grade U.S. bond market, rose by 2.94 percent for the first quarter. Falling interest rates and declining risk premiums were the key drivers of performance for the quarter. Interest rates, as measured by the 10 year U.S Treasury note, declined meaningfully for the quarter and ended at 2.41 percent which was 0.28 percent lower than where it ended the previous year. Short term interest rates fluctuated to a lesser degree during the quarter as they tend to follow the Fed Funds Rate which was unchanged for the quarter.

All major investment grade credit and securitized sectors including corporate, municipal, mortgage backed, and agency bonds outperformed similar duration U.S. Treasury securities for the quarter. Within the investment grade corporate sectors, longer duration assets outperformed shorter duration and lower quality sectors outperformed higher quality. Improving sentiment around the trade conflict with China, a more dovish Fed, and decent corporate earnings fueled positive returns for the quarter.

Looking forward, Miles Capital anticipates slower but solid economic activity for the upcoming quarters which should ultimately provide modest upward pressure on interest rates across the curve. These gradual rising rates will tend to drive overall fixed income returns to lower absolute levels. We expect a moderate decline in risk premiums for the major investment grade spread sectors which should offset some of the lower returns due to higher interest rates. Potential risks we are monitoring which could derail our outlook include an escalation of trade wars, a hard Brexit in Europe, or an unexpected spike in inflation later this year which would necessitate a more aggressive Fed and higher short term interest rates.

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JUNE 12
ISFIS Annual Conference
Iowa Schools Finance Information Services

JULY 25
IACCT Annual Conference
Iowa Association of Community College Trustees

HOLIDAYS

APRIL 19
Good Friday

MAY 27
Memorial Day

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